

Message Text

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ACTION EUR-12

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SSO-00 USIE-00 INRE-00 /074 W
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O 131118Z JAN 77
FM AMEMBASSY LONDON
TO TREASURY DEPT WASHDC IMMEDIATE
SECSTATE WASHDC IMMEDIATE 9418

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DEPARTMENT PASS FEDERAL RESERVE BOARD

E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: THE PRIME MINISTER ASSUMES COMMAND OF INDUSTRIAL
AND FINANCIAL POLICY

1. QUALITY PRESS THIS MORNING HEADLINE THAT PRIME MINISTER CALLAGHAN IS TAKING DIRECT CONTROL OF INDUSTRIAL POLICY AND THE POUND. DISCUSSIONS WITH SENIOR TREASURY OFFICIALS INDICATE THAT THE SOURCE OF THIS INFORMATION COMES FROM CALLAGHAN'S PRESS OFFICE. AS YET THERE ARE NO OFFICIAL STATEMENTS BUT THE SUBSTANCE OF THE BACKGROUND PRESS BRIEFINGS ARE CLEAR. ONE SOURCE SPECIFICALLY CITED THE FOLLOWING PARAGRAPHS FROM AN ARTICLE ENTITLED "PM TAKES CHARGE OF THE POUND" BY SIMON HOGGART, THE GUARDIAN'S POLITICAL CORRESPONDENT:

QUOTE MR. CALLAGHAN INTENDS TO TAKE DIRECT PERSONAL SUPERVISION OF BRITAIN'S INDUSTRIAL POLICY AND THE FATE OF THE POUND, IN A MOVE THAT WILL EFFECTIVELY DEMOTE MR. HEALEY'S OFFICE.

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IT WAS BEING HEAVILY STRESSED THAT THE PRIME MINISTERS MOVE DOES NOT REFLECT ON THE CHANCELLOR. MR. CALLAGHAN'S DECISION ALSO REFLECTS HIS DOUBT AND DISSATISFACTION WITH THE PERFORMANCE OF THE TREASURY AS WELL AS THE SOMEWHAT LACKLUSTRE RESPONSE OF BRITISH INDUSTRY TO THE EXPORT OPPORTUNITIES NOW OPEN.

THE TREASURY IS STILL THE MOST POWERFUL CIVIL SER-

VICE DEPARTMENT IN WHITEHALL, BUT OVER THE PAST YEAR OR SO HAS BECOME INCREASINGLY SUSPECT TO BOTH MAIN PARTIES. THE DOUBT WAS RAISED AGAIN BY THE HANDLING OF STERLING'S SWIFT FALL LAST SEPTEMBER.

THE PRIME MINISTER, WHO INTENDS FREQUENT MEETINGS WITH MR. HEALEY AND THE GOVERNOR OF THE BANK OF ENGLAND, GORDON RICHARDSON, WILL KEEP A SPECIAL EYE ON INTERVENTION POLICY IF THE POUND STARTS TO FALL AGAIN, AND HE WILL PERSONALLY MAKE SURE THAT STERLING BALANCES ARE NOT ALLOWED TO BUILD UP AFTER THE NEGOTIATION OF THE \$3,000 MILLIONS SAFETY NET EARLIER THIS WEEK. END OF QUOTE

2. SIMILAR LINE CAN BE SEEN FROM FRONT-PAGE FINANCIAL TIMES ARTICLE ENTITLED, "CALLAGHAN TAKES CONTROL OF INDUSTRIAL POLICY" BY PHILIP RAWSTORNE.

QUOTE ...MR. HEALEY WILL CERTAINLY REMAIN AS CHANCELLOR TO PRESENT THE NORMAL SPRING BUDGET AND TO PLAY A BIG PART IN NEGOTIATIONS WITH THE TUC ON THE NEXT PHASE OF VOLUNTARY PAY RESTRAINT.

THE PRIME MINISTER'S DECISION, HOWEVER, CLEARLY REFLECTS SOME PERSONAL DOUBTS AT LEAST ABOUT THE HANDLING OF THE RECENT STERLING CRISIS BY THE TREASURY AND THE BANK OF ENGLAND, AND HIS GROWING IMPATIENCE WITH THE PERFORMANCE OF INDUSTRY.

SOME CONSERVATIVE LEADERS BELIEVE THAT MR. CALLAGHAN HIS POLITICAL CONFIDENCE RENEWED BY THE BASLE "SAFETY NET" AGREEMENT HAS ALSO BEEN MOTIVATED BY EAGERNESS TO LAY FOUNDATIONS DURING THE YEAR FOR THE GOVERNMENT'S ELECTORAL LIMITED OFFICIAL USE

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RECOVERY.

THE \$3BN. FACILITY PROVIDED BY THE BANK FOR INTERNATIONAL SETTLEMENTS--FOR WHICH HE CLAIMS CREDIT--CERTAINLY APPEARS TO HAVE BEEN AN IMPORTANT FACTOR.

HE IS SAID TO BELIEVE THAT, WITH STERLING SECURELY PROTECTED AGAINST ANY SERIOUS PRESSURES, THE MAIN THRUST OF THE GOVERNMENT'S POLICY SHOULD NOW BE DIRECTED TOWARDS THE INDUSTRIAL FRONT. END QUOTE.

3. SAM BRITTAN IN AN FT ARTICLE ENTITLED "TURNING AWAY A GREAT OPPORTUNITY" GIVES A MIXED, BUT BASICALLY CRITICAL VIEW OF THE BASLE FACILITY. THE AGREEMENT COULD HAVE BEEN IN PLACE OVER A YEAR AGO WERE IT NOT HELD UP BY THE RELUCTANCE OF THE ORTHODOX WING OF THE TREASURY AND BANK OF ENGLAND TO SEE THE OVERHANG OF THE STERLING BALANCES AS DESTABILIZING THE FOREIGN EXCHANGE MARKETS. AGREEMENT WAS ALSO HELD UP BY UNWILLINGNESS OF KEYNESIAN WING OF GOVERNMENT TO ADOPT FIRM MONETARY OBJECTIVES AND CURB PUBLIC EXPENDITURE, BUT WITHOUT THIS, THERE WOULD NOT HAVE BEEN A

BASLE AGREEMENT.

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MOST IMPORTANT PART OF THE BASLE AGREEMENT IS NOT
THE AMOUNT, BUT THE GENEROUS REPAYMENT PERIOD. THE
NOVEL FEATURE IS THE CONVERSION OFFER INTO FOREIGN CUR-
RENCY DENOMINATED BONDS, WHICH IS A MAJOR IMPROVEMENT OVER
THE EXCHANGE RATE GUARANTEE IN THE 1968 AGREEMENT.

QUOTE I WOULD BE LESS SOUR AND WOULD BE PREPARED TO LET
BYGONES BE BYGONES WERE IT NOT FOR ALL THE SIGNS THAT THE
AUTHORITIES ARE THROWING AWAY THE OPPORTUNITIES PROVIDED
BY THE NEW ARRANGEMENTS AND BY THE IMPROVEMENT IN SENTI-
MENT TOWARDS STERLING AS THEY DID IN A COMPARABLE PERIOD
IN THE EARLY 1970S.

IF ABANDONING THE RESERVE ROLE OF STERLING MEANS THAT
WE STOP TRYING TO RIG INTEREST RATES IN LONDON TO ATTRACT
FOREIGN FUNDS, AND STOP LEANING ON GOVERNMENTS TO HOLD
THEIR RESERVES IN LONDON TO BOLSTER THE STERLING EXCHANGE
RATE ARTIFICIALLY, THEN WE SHOULD HAVE ABANDONED IT
YEARS AGO. BUT IF ABANDONING THE RESERVE ROLE MEANS DIS-
SUADING HOLDERS OF FUNDS WHO WISH TO PUT SOME OF THEIR
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CASH BALANCES INTO LONDON VOLUNTARILY, THEN THE WHOLE THING IS AN ABSURDITY, AND IT MEANS IN PRACTICE A QUITE UNNECESSARY DEPRESSION OF BRITISH LIVING STANDARDS.

WHAT OUR RULERS ARE REALLY SAYING IS THAT IF PEOPLE IN OTHER COUNTRIES WANT TO LEND US SOME OF THEIR SAVINGS, WE ARE GOING, PURITANICALLY, TO TURN THEM AWAY, AND THAT WE ARE ONLY INTERESTED IN AN OVERSEAS BALANCE ACHIEVED BY PHYSICAL EXPORTS (OR BY NATIONALISED INDUSTRY BORROWING UNDER TREASURY GUARANTEE). THE POINT IS A VERY PRACTICAL ONE. THE OPEC COUNTRIES ARE STILL RUNNING A CURRENT SURPLUS OF AROUND \$40BN., WHICH MEANS THAT THEY HAVE A NET SAVINGS SURPLUS OF THAT AMOUNT. WE HAVE MOVED FROM THE 1974 EXTREME OF RIGGING MARKETS TO HOG AS MUCH OF THIS SURPLUS AS POSSIBLE, TO RIGGING MARKETS THE OTHER WAY ROUND TO SAY THAT WE WANT NO PART OF IT. END QUOTE.

BRITTAN CONSIDERS THAT AN UPWARD MOVEMENT IN THE EXCHANGE RATE WOULD PROVIDE A FAR MORE EFFICIENT METHOD OF BRINGING THE RATE OF INFLATION DOWN THAN AN INCOMES POLICY, ADDING THAT EXCHANGE RATE CHANGES HAVE ONLY LIMITED POWER TO CHANGE THE RATIO OF MANUFACTURING PRICES IN FAVOR OF THE UK. ARMSTRONG

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